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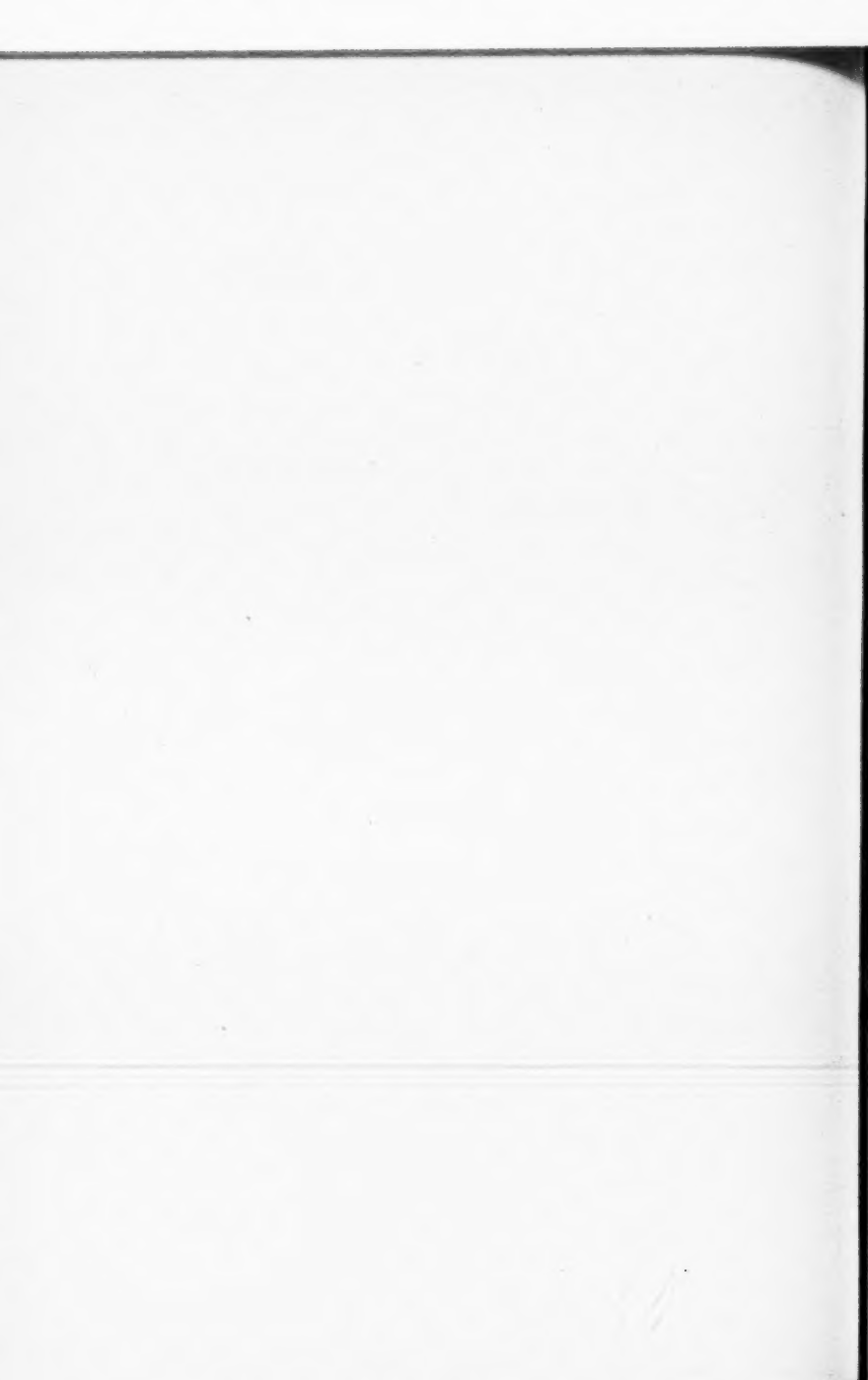
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# **In the Supreme Court of the United States**

OCTOBER TERM, 1942

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No. 665

**H. F. METCALF, AS TRUSTEE IN BANKRUPTCY OF THE  
ESTATE OF F. P. NEWPORT CORPORATION, LTD.,  
A CORPORATION, BANKRUPT, PETITIONER**

*v.*

**UNITED STATES OF AMERICA**

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE NINTH  
CIRCUIT*

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**BRIEF FOR THE UNITED STATES IN OPPOSITION**

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## **OPINIONS BELOW**

The District Court rendered no opinion, but adopted as its findings of fact and conclusions of law the findings and conclusions of the referee in bankruptcy (R. 188-189). The latter may be found at R. 28-41. The opinion of the Circuit Court of Appeals (R. 204-210) is reported at 131 F. 2d 677.

## **JURISDICTION**

The judgment of the Circuit Court of Appeals was entered November 23, 1942 (R. 211). The

petition for a writ of certiorari was filed on January 20, 1943. Jurisdiction is conferred on this Court under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

#### **QUESTION PRESENTED**

Whether the trustee in bankruptcy of a corporation engaged in the business of buying and selling real property for profit, who took over the bankrupt's assets, entered upon a program of selling the properties over a period of time, made repairs and improvements, and executed oil and gas leases was "operating the property or business" within the meaning of Section 52 of the Revenue Act of 1938 and Section 52 (a) of the Internal Revenue Code and therefore subject to income tax upon the net income derived from such activities.

#### **STATUTES AND REGULATIONS INVOLVED**

Revenue Act of 1938, c. 289, 52 Stat. 447, provides:

##### **SEC. 52. CORPORATION RETURNS.**

Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title and such other information for the purpose of carrying out the provisions of this title as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall

be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Section 52 (a) of the Internal Revenue Code (U. S. C. Title 26, Sec. 52) is identical with this provision.

Treasury Regulations 101 promulgated under the Revenue Act of 1938 provides:

ART. 52-2. *Returns by receivers.*—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations. If a receiver has full custody of and control over the business or property of a corporation, he shall be deemed to be operating such business or property within the meaning of section 52, whether he is engaged in carrying on the business for which the corporation was organized or only in marshaling, selling, and disposing of its

assets for purposes of liquidation. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. (See sections 274 and 298 and articles 274-1 and 274-2.) A receiver in charge of only part of the property of a corporation, however, as, for example, a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income.

Section 19.52-2 of Treasury Regulations 103, promulgated under the Internal Revenue Code, is identical with this provision.

#### STATEMENT .

The facts were stipulated (R. 50-60). The findings of the referee, which were adopted by the District Court, may be summarized as follows:

The F. P. Newport Corporation, Ltd., a Delaware corporation organized in 1929, conducted a real-estate business in California (R. 31). On January 12, 1937, it was adjudicated a bankrupt, and on March 18, 1937, H. F. Metcalf was appointed trustee. Since that date the trustee has

had possession and control of all the bankrupt's property and assets, consisting of numerous parcels of improved and unimproved real estate, accounts, promissory notes, bills receivable, and other tangible and intangible property. (R. 31-32.)

Prior to the filing of the petition in bankruptcy, approximately 90 per cent of the company's real estate was encumbered by a deed of trust in favor of the Security-First National Bank of Los Angeles, to secure an indebtedness in excess of \$1,300,000 (R. 32). An agreement was reached between the trustee and the bank, with the approval of the District Court, authorizing the trustee to sell the property covered by the deed of trust and to collect rents and income from the properties (R. 32-33, Stip. Ex. A, R. 61). Amounts received by the trustee were to be applied to taxes and upkeep expenses, and the balance was to be used to pay the principal and interest on the loan (R. 69-70). All sales made by the trustee were duly approved by order of the court. Pending sale, some of the properties were rented by the trustee mainly for agricultural purposes. Repairs were made upon certain properties, and improvements were made upon others to preserve them from the hazards of fire and flood. (R. 35.)

Among the real properties of the bankrupt which are located in the City of Long Beach, California, and title to which is held by the bank under the declaration of trust, are two parcels—one of three and the other of six acres, separated

by an intervening three-acre parcel belonging to third persons (R. 33). During the pendency of the bankruptcy proceeding, producing oil and gas wells were drilled and other wells were being drilled or about to be drilled on nearby lands which adjoined the two parcels (R. 33). Both the trustee and the Bank feared that the operation of these wells would drain away the oil and gas believed to underlie the bankrupt's land (R. 33). Since the trustee did not have sufficient funds to enable him to drill any oil or gas wells, he leased the two parcels of land to Universal Consolidated Oil Company after securing the approval of the court for the transaction (R. 33). Other lots in the same general area which were not of sufficient size to be covered by separate leases were included in a community oil and gas lease wherein the Bankline Oil Company was the lessee (R. 34).

Oil and gas royalties including bonuses actually paid to the trustee under the terms and provisions of the leases amounted to \$245,517.65 during the year 1938, and \$206,333.36 during the year 1939 (R. 34). Upon orders of the court, these moneys were paid by the trustee to the bank to cover taxes assessed against the properties, costs of engineering services for checking oil and gas production on the leased property, and interest and principal owing to the bank (R. 34).

While no general order of the court was made authorizing the trustee to conduct the business of



the bankrupt corporation, several specific orders were made authorizing the conduct of business activities. Thus, in addition to negotiation of the oil leases, the trustee was authorized by the court to renew contracts with the Oil Field Testing and Engineering Company, Inc., for checking oil and gas production on that property, to lease (pending sale) a building belonging to the bankrupt estate for the storage of hay, to lease (pending sale) certain unsubdivided lands, to grant easements and rights-of-way to the City of Los Angeles and County of Los Angeles for street purposes, and to enter into agreements with the City of Long Beach concerning rights to oil and gas produced under the above-mentioned Universal Consolidated Oil Company lease pending determination of title disputes to the property covered by the lease. (R. 36.)

In the two tax years, only \$24,950 of a total of \$492,150.33 in receipts came from the sale of real estate. Over \$451,850 came from leasing the oil properties. Other income came from leasing miscellaneous properties. (R. 37-39.)

The referee's findings of fact, and his conclusion of law that the trustee was not operating the property or business of the bankrupt corporation within the meaning of Section 52 of the Revenue Act of 1938 and Section 52 (a) of the Internal Revenue Code, were adopted by the District Court (R. 28-41, 188-189).

The court below reversed the District Court, holding that on the facts as above stated the trustee was operating the property and business of the bankrupt within the meaning of Section 52 (R. 211).

#### ARGUMENT

The evident purpose of Congress in enacting Section 52 of the income tax statute was to extend the general income tax imposed on corporations to the theretofore untaxed income received by receivers, trustees in bankruptcy, or assignees, when they are engaged in operating the business or property of which they have custody or control. See *Reinecke v. Gardner*, 277 U. S. 239; *United States v. Chicago & E. I. Ry. Co.*, 298 Fed. 779 (N. D. Ill.). This broad purpose would not be fostered by a restrictive construction of the phrase "operating the property or business." The facts of the instant case show clearly that the petitioner was "operating the property or business" of the corporation within the meaning and purpose of the statute.

The decision of the court below that petitioner was thus "operating the property or business" of the bankrupt turns entirely upon the application of standard legal principles to the peculiar facts of this case. *In re Heller, Hirsh & Co.*, 258 Fed. 208 (C. C. A. 2), is not in conflict with this decision, since in that case the trustee in bankruptcy did nothing more than collect the proceeds of a

claim which he compromised and which arose under a contract entered into and completely executed by the corporation prior to the bankruptcy. Nor is *In re Owl Drug Co.*, 21 F. Supp. 907 (Nev.), relevant here, since that case involved only the taxability of the interest earned on the proceeds realized from the liquidation of the business.

#### CONCLUSION

The decision of the court below is correct. It presents no conflict or question of general importance which would warrant further review by this Court. We respectfully submit that the petition should be denied.

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FEBRUARY 1943.